U.S. Department of Agriculture

Office of Inspector General
Southeast Region

Audit Report

Rural Housing Service
Single-Family Housing Program, Borrower Income Verification Procedures

Report No. 04099-341-At
August 2006

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

August 14, 2006

REPLY TO
ATTN OF: 04099-341-At

TO: Russell T. Davis
Administrator
Rural Housing Service

THROUGH: John Dunsmuir
Acting Director
Financial Management Division

FROM: Robert W. Young /s/ Marlane T. Evans (for)
Assistant Inspector General
for Audit

SUBJECT: Rural Housing Service, Single-Family Housing Program, Borrower Income Verification Procedures

This report presents the results of our audit of the Rural Housing Service (RHS) Centralized Servicing Center's (CSC) controls over payment subsidies in the Single-Family Housing (SFH) Direct Loan Program. Your June 30, 2006, response to the draft report is included as exhibit B with excerpts and the Office of Inspector General's (OIG) position incorporated into the relevant sections of the report.

Overall, we found that CSC was adequately monitoring payment subsidies to ensure their accuracy. However, we found areas where improvements could be made. CSC: (1) has not performed cost-benefit analysis to establish a minimum dollar threshold for collecting unauthorized payment subsidies and used this unsupported dollar threshold in their determination of what percentage of unreported borrower income to refer for investigation; (2) uses a flawed sampling methodology to estimate the overall error rate in its universe of payment subsidies; and, (3) does not request tax return information from the Internal Revenue Service (IRS) as a tool to verify borrower incomes. As a result, CSC has not maximized its ability to collect unauthorized payment subsidies or to ensure that payment subsidies are accurate.

BACKGROUND

RHS, an agency within the Rural Development (RD) mission area of the Department of Agriculture (USDA), provides funding for SFH loan programs. The RHS National Office in

Washington, D.C., administers the programs through 47 State offices and a network of field offices nationwide. Within RHS, the CSC, which is located in St. Louis, Missouri, was established in January 1997, to service SFH direct loans. The CSC has an Unauthorized Assistance Unit (UNA) that investigates cases of unreported income of borrowers to identify unauthorized payment subsidies.

RHS makes loans to help low and very low income persons unable to obtain credit elsewhere acquire adequate housing in rural areas. Borrowers are eligible to receive payment assistance (formerly called interest credit) to subsidize their loan payments based, in part, on their income. The average annual income of a direct loan borrower is about $17,000. Approximately 45 percent of borrowers in the direct loan program receive subsidy payments which reduce their monthly house payments. Borrowers apply for SFH loans at local RD field offices. The field offices process applications, determine borrower eligibility for loans, verify household incomes, determine initial payment subsidies, and originate the loans. After the field offices' initial certification, CSC is responsible for recertifying borrower eligibility for payment subsidies at least once every 24 months.

Borrowers must notify CSC whenever (1) an adult household member changes or obtains employment, (2) household composition changes, or (3) the household's annual income increases by at least 10 percent.[1] To monitor the accuracy of payment subsidy certifications, CSC evaluates a 1-percent quality control (QC) sample of subsidy agreements annually to determine the accuracy of the subsidy payments. CSC may adjust the borrower's subsidy payment if the (10 percent) increase in the borrower's income also results in at least a 10-percent change in the borrower's house payment.[2]

OBJECTIVES

Our objectives were to assess RHS controls over (a) the accuracy of payment subsidies for SFH direct loan borrowers and (b) the effectiveness of RHS' claims management system to establish, record, and pursue collections of unauthorized payment subsidies.

SCOPE AND METHODOLOGY

We reviewed RHS controls to ensure the propriety of borrower payment subsidies made in fiscal year (FY) 2004. During that period, RHS awarded $357 million in payment subsidies. Audit fieldwork was performed from October 2004 through September 2005. Our review was performed in accordance with generally accepted government auditing standards.

The work was performed at RHS Headquarters in Washington, D.C., and the CSC in St. Louis, Missouri. We (a) interviewed RHS and CSC officials involved in the SFH program to determine their duties and responsibilities; (b) reviewed RHS and CSC controls that are used to determine and monitor the accuracy of borrower income verifications and payment subsidy certifications; (c) evaluated CSC's procedures for selecting and performing its 1-percent review of payment

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[1] Title 7 *Code of Federal Regulations* (C.F.R.) Chapter XXXV, Part 3550.157(a)(3), dated January 1, 2003.
[2] Title 7 C.F.R. Chapter XXXV, Part 3550.68(e) and Part 3550.157(a)(3), dated January 1, 2003.

subsidies; (d) evaluated CSC's procedures for recovering unauthorized payment subsidies; (e) evaluated CSC's use of wage matching data to identify borrower income for payment subsidy; (f) evaluated CSC's use of IRS income tax information and W-2 forms as methods to help identify unreported income for payment subsidy renewals; and, (g) obtained program universe data on SFH direct loans and payment subsidies.

FINDINGS AND RECOMMENDATIONS

FINDING 1: Cost-Benefit Analysis Needed to Support Decisions Related to Cost Recovery Efforts for Unauthorized Payment Subsidies and Investigative Referrals

Analysis Needed to Support Threshold to Collect Unauthorized Payment Subsidies

CSC does not pursue collection of unauthorized payment subsidies until they exceed $1,000. CSC officials stated that they established the $1,000 threshold based on the costs of (a) investigating the unreported incomes; (b) pursuing the collection of the claims; and (c) defending claims through arbitration and appeals. However, the agency has not performed a cost-benefit analysis to support the $1,000 threshold. As a result, RHS did not attempt to collect unauthorized payment subsidies totaling $194,777 in FY 2004.

As support for establishing the $1,000 collection threshold, the CSC provided us with a document that showed the average cost of $840 to investigate borrowers with suspected unauthorized payment subsidies and $200 to collect an unauthorized payment subsidy in FY 2000. We assessed the reasons given by RHS for the $1,000 threshold and concluded that (a) the UNA investigations are done to *identify* the unauthorized payment subsidy and the investigative cost occurs regardless of whether collection of the unauthorized payment subsidy is pursued or not; therefore investigative costs cannot be considered as part of the cost of *collecting* unauthorized payment subsidies; (b) the cost of collecting unauthorized payment subsidies that are in a delinquent payment status may be charged against the borrower's account[3]; and, (c) RHS could not provide any evidence of the excessive cost or frequency of borrower arbitration or appeals.

CSC stated that it does not charge borrowers the costs of pursuing collection of unauthorized payment subsidies because it would place these low income borrowers at an increased risk of foreclosure. However, CSC could not provide us with any information to substantiate its claim. At our May 10, 2006, exit conference, RHS also stated that a majority of the unauthorized assistance cases never become delinquent because they are resolved within 30 days of the claim being established. RHS stated further that the agency would only charge the borrower the costs to collect a delinquent claim if the claim occurred because of borrower fraud.

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[3] Title 31 *United States Code* (U.S.C.), section 3717(e), dated January 19, 2004, and 31 C.F.R. Chapter IX, Part 901.9 (c), dated July 1, 2004.

Implement An Appropriate Threshold for Referring Cases for Investigation

CSC does not refer borrowers to the UNA for investigation until the borrower's income has had an increase in unreported income of more than 20 percent. CSC stated a 20-percent change in income threshold was established based on their management experience and supported by their borrower income analysis. RHS also stated that the 20-percent threshold was appropriate in order to avoid the costs associated with computing and developing small claims, and reduce the expenses resulting from borrower appeals and legal arbitration. However, CSC used its unsupported $1,000 collection threshold as the basis for the computation of the 20-percent referral threshold. Therefore, the 20-percent threshold is equally unsupported. Although UNA has been successful in identifying $15.4 million of unauthorized payment subsidies once a borrower is referred to the UNA for investigation, CSC has no assurance that it is referring all those cases that could be cost effectively handled by UNA.

RECOMMENDATION 1:

Conduct a cost-benefit analysis to identify the dollar threshold to collect unauthorized assistance. Revise the *RD Handbook(s)* accordingly.

Agency Response:

In its June 30, 2006, response, CSC states that they did perform a unit cost analysis in Fiscal Year (FY) 2001 using FY 2000 data. The data established that the $1,000 minimum unauthorized assistance (UNA) collection threshold is appropriate. However, RHS added that they agree that an updated cost analysis is warranted and pending result of the updated analysis, will adjust the Handbooks accordingly. The original cost-benefit did not include litigious expenses. These will be included in the future analysis.

OIG Position:

We do not accept RHS' proposed action for this recommendation. We clearly acknowledged in the report that CSC had performed a unit cost analysis; however, we also stated that the CSC unit cost analysis includes costs other than the costs to collect unauthorized assistance, and is therefore not an acceptable cost-benefit analysis.

CSC performed a unit cost analysis that included both program integrity (cost to investigate a potential claim of unauthorized assistance) and collection costs (the costs to pursue the recovery of unauthorized assistance). The CSC's unit cost analysis used both the UNA investigative costs of $840 and collection costs of $200 to justify the $1,000 threshold. The UNA investigative costs of $840 should not have been included as a cost to collect unauthorized assistance in CSC's analysis. The cost to collect unauthorized assistance does not begin until an amount owed is established as a claim, and this occurs after the UNA investigation and its related costs. Second, the unit cost analysis included the losses on foreclosed properties. Foreclosure costs were not directly tied to collection activities for an improper payment, but are the result of the foreclosure action. RHS needs to perform a cost-benefit analysis that accurately reflects those costs actually incurred for collection activities. CSC also needs to establish an appropriate collection threshold to pursue unauthorized assistance.

To reach management decision, RHS needs to complete and provide a cost-benefit analysis. Further, if litigious expenses are to be included in the cost-benefit analysis, the costs should be supported by historical costs of litigation directly associated with the cost of collecting unauthorized assistance.

RECOMMENDATION 2:

Based on the results of the cost-benefit analysis to identify the dollar threshold for pursuing collection of unauthorized assistance, compute the percentage increase of borrower income needed for referral to the UNA unit. Revise the *RD Handbook(s)* accordingly.

Agency Response:

In its June 30, 2006, response, CSC stated, upon completion of the cost-benefit analysis as noted above, we agree to compute the percentage increase of income needed for referral to the UNA unit. We further agree to provide OIG the cost-benefit analysis and percentage increase in borrower income threshold documentation by October 2006. We again appreciate any recommendations that the OIG have to offer in updating the cost analysis.

OIG Position:

To reach management decision, RHS must provide the cost-benefit analysis to collect unauthorized assistance as described in Recommendation 1. Further, RHS needs to establish a collection threshold for unauthorized assistance, compute the percentage increase of borrower income needed for referral to the UNA unit, and revise *RD Handbook(s) accordingly*.

RECOMMENDATION 3:

Revise *RD Handbook(s)* to require borrowers to pay costs associated with pursuing/collecting delinquent unauthorized payment subsidies.

Agency Response:

In its June 30, 2006, response, RHS stated, RD does not agree with this recommendation. The audit report states that, "the cost of pursuing unauthorized payments subsidies that are in delinquent payment status may be charged against the borrower's account." Unauthorized assistance is not delinquent debt. Title 31 U.S.C. section 3717 (e) does not require the cost of a UNA investigation to be passed on to the borrower. Title 7 C.F.R. 3550.164 and HB-2-3550, Chapter 7, section 1 clearly defines the agency's collection strategy to ensure collection or resolution of UNA debt prior to becoming delinquent.

<u>OIG Position</u>:

We do not accept RHS' proposed action for this recommendation. In effect, RHS has taken the position that because it reamortizes unauthorized assistance before it becomes delinquent debt (i.e., the agency's collection strategy), that RHS has no delinquent unauthorized assistance and thus needs no procedures to handle delinquent debt. Our report recognizes that unauthorized assistance may not be delinquent debt; however, it may become delinquent if it has not been paid by the date specified in the agency's initial demand for repayment unless other satisfactory payment arrangements have been made. The only costs that should be assessed to borrowers are those costs associated with collecting a **delinquent** debt as required by Federal Claims Collection Standards.

Our review of RHS' policies, procedures, and handbooks found that they were not in compliance with collection standards. Federal Regulations, 31 C.F.R. Chapter IX, part 901.9(c) requires that, "Agencies shall assess administrative costs incurred for processing and handling delinquent debts. The calculation of administrative costs should be based on actual costs incurred or upon estimated costs as determined by the assessing agency."

To reach management decision, RHS needs to revise its *RHS Handbook(s)* to incorporate the Federal Claims Collection Standards that requires the assessment of administrative costs incurred for processing and handling delinquent debts.

<u>FINDING 2</u>: CSC's 1-Percent QC Review Uses a Flawed Sampling Methodology to Estimate the Overall Error Rate in its Universe of Payment Subsidies

Although CSC regularly conducts QC reviews to ascertain the accuracy of SFH loan payment subsidies, we found that CSC's sampling methodology was not properly designed to randomly select the sample from the entire universe of borrower renewals. CSC incorrectly limited the QC universe to only renewals that had previously received a supervisory review (i.e., 3-percent sample that includes payment subsidy renewals). In addition, replacement samples for duplicate selections were not selected randomly. CSC maintains that this process produces an error rate that is representative of the overall error rate of payment subsidy renewal computations. However, we have concluded that the QC process is flawed, and therefore the overall payment subsidy error rate calculated from this limited sample may not necessarily correspond to the true rate of error for the entire SFH loan subsidy program.

CSC's Handbook[4] requires a QC review of borrower income, on a random[5] basis, for at least 1 percent of all payment subsidy renewals and CSC's audit desk procedures require the results of this review to be used to determine whether CSC accurately computes all borrower payment assistance.

According to our statistician, random sampling is an unbiased selection of units from a population that allows valid, supportable inferences to be made about the entire universe

[4] *CSC Handbook* 2-3550, Paragraph 4.6 C., "IN-DEPTH REVIEWS."
[5] The definition of "random" is a sample in which each item in the universe has an equal chance of being included.

sampled. A valid random, or otherwise statistical, sample requires that the sample be taken using a random number generator, or software that produces random numbers. This sample selection must be applied to the entire universe upon which the user wishes to make a statement regarding the level of accuracy, errors, etc. Conversely, a judgmental sample is a biased, subjective selection of units from a universe. The units selected in a judgmental sample only represent themselves. Therefore, a judgmental sample's results cannot be validly projected to the universe.

CSC has a two phase process for estimating the error rate in its payment subsidy universe. In the first step, which is done primarily to test the accuracy of all servicing work being done at CSC, supervisors are required to review 3 percent of the tasks that their workers process, including payment subsidy calculations. Second, CSC takes its 1-percent QC sample out of the 3-percent sample in order to test the accuracy of payment subsidy calculations. This process is flawed for the following reasons.

1. The 3-percent sample was judgmentally taken by the supervisors. CSC has not developed any sampling procedures to ensure that no sampling bias is introduced in selecting worker's tasks for review.
2. Since the 3-percent sample was not selected randomly, the 1-percent sample (drawn from the 3-percent sample) also cannot be considered a random sample of the universe of all payment subsidies. This process excludes 97 percent of the payment subsidy universe from testing.
3. Duplicate numbers selected for the 1-percent sample were also replaced judgmentally.
4. The 1-percent sample is drawn from a universe where the supervisory review should have already caught and corrected any errors that were made.

CSC told us that it realized that the 3-percent sample may not be what OIG would consider a true statistical sample, but that CSC believed that the sample was sufficient for its purposes. However, if the results of the 1-percent QC review are to be used by CSC as being representative of the entire universe of payment subsidy renewals, then CSC must design the QC review to randomly select its sample from the entire universe of borrower renewals without bias. At our exit conference on May 10, 2006, CSC stated it had revised its QC review procedures effective October 25, 2005. We did not assess these procedures as they occurred after fieldwork was completed, but will assess their soundness during the report resolution process.

RECOMMENDATION 4:

Develop and implement a sound QC review sampling plan that randomly selects the 1-percent QC sample from the entire universe of payment subsidy renewals.

Agency Response:

In its June 30, 2006, response, RHS stated that on October 25, 2005, it implemented a new sampling method that is more direct and eliminates the confusion of the prior two-part sample methodology. An automated Excel generator now produces our 1-percent sample. However, RHS added that the report's conclusions were based only on the assertion of an OIG statistician, and that its two-part sample method did meet the OIG definition of random.

OIG Position:

As discussed in our report, OIG based its conclusions upon the expert advice of an OIG statistician who has over 26 years of experience. The CSC 1-percent sample was not random nor was the 3-percent sample that preceded it random. CSC's decision to eliminate the non-random part of its sampling procedure indicates its recognition that the sampling process was not random. To reach management decision, RHS needs to provide us with its sampling plan to perform its 1-percent QC sample.

FINDING 3: CSC QC Reviews Do Not Use Independent Federal Tax Information to Verify Borrower Incomes

CSC QC review procedures do not require borrowers to sign IRS release Form 4506-T, "Request for Transcript of Tax Return," which IRS requires to provide tax return information to third parties. CSC officials stated that this was unnecessary because they project income forward for payment subsidies based on an employee's last two pay stubs, award letters, or other verification means. However, CSC does require borrowers to provide their tax returns at subsidy renewal.

We believe that requiring all borrowers to sign the IRS release Form 4506-T, "Request for Transcript of Tax Return," will improve the integrity of the program for two reasons. First, all borrowers will be on notice that income information provided to RHS is subject to verification by the IRS. Second, the release can be used as an additional control during the 1-percent QC review process to determine the accuracy of borrower household income needed to accurately determine payments subsidies and identify potential referrals to the UNA for providing inaccurate information. At our exit conference on May 10, 2006, CSC again stated that it was projecting future income based on a household's current income to determine a correct payment subsidy amount and that the last two pay statements were the best indication of future income. The purpose of the 1-percent QC review is to determine whether CSC staff correctly determines borrower subsidies at renewal, and provides assurance that borrower income information was accurate. Without obtaining these independent IRS documents, RHS cannot be certain that borrowers' payment subsidies have been correctly calculated during its 1-percent review.

RECOMMENDATION 5:

Revise *RD Handbook(s)* to require all adult taxpayers in a borrower's household to submit a signed IRS Form 4506-T, "Request for Transcript of Tax Return," as a condition of eligibility for payment subsidy.

Agency Response:

In its June 30, 2006, response, RHS provided one response for Recommendations 5, 6, and 7 and stated RD "projects" income for the next 12 months to ensure that subsidy matches the needs of the customer. This recommendation is based in large part upon a previous OIG recommendation. Last year's income tax return is old data which does not accurately reflect the current income of our customers. Thus, the income presented on the Federal income tax return is not useful for this process.

RD contends that current household income from the most recent pay stubs or award letters provides the most accurate basis for projecting future earnings.

OIG Position:

We do not accept RHS' proposed action for Recommendation 5. Our position only addresses the portions of RHS' response that constructively apply to our recommended corrective actions.

Projecting income to determine benefits is not new to USDA programs. Because Wage and Benefit matching are not presently available to RHS, a borrower's income tax return is the only information available to help identify unreported borrower employment. Further, as part of RHS' recertification process, borrowers are required to provide their two most recent income tax returns along with their most recent pay stubs as a method of verifying borrowers' income. *RD Handbook(s)*, HB-2-3550, attachment 4-E page 2 of 3, provides,

"The tax return reports last year's income, rather than the current income the borrower is asked to report on the application. Even so, it can serve as a valuable verification tool. Check the reported income, dependents, assets, with the information provided on the application. Identify and clarify with the borrower any information that appears inconsistent with the application."

The impact to be achieved by the CSC obtaining a borrower tax transcript directly from the IRS is a control to validate that all employment and income was reported. Further, it places borrowers on notice that information provided to RHS on their renewal application is subject to verification. As the CSC's UNA unit has effectively demonstrated, borrowers do not always report all of their income resulting in improper payments.

We contend that confirming borrower reported information with independent sources, such as the IRS, during a QC review is needed to provide assurance that borrower information was accurately reported. Since program funding is limited, if a borrower is receiving benefits for which they are not entitled, then other eligible individuals are prevented from receiving benefits for which they qualify. Further, RHS has acknowledged in its procedures that borrower tax returns can serve as a valuable verification tool.

To reach management decision, RHS needs to provide us a copy of its revised *RD Handbook(s)* that requires all taxpayers in a borrower's household to submit a signed IRS Form 4506-T, "Request for Transcript of Tax Return." This would allow independent verification, if necessary.

RECOMMENDATION 6:

Revise *RD Handbook(s)* to require CSC's 1-percent QC review procedures to require use of tax return information obtained from the IRS when determining payment subsidy accuracy.

Agency Response:

See Agency Response for Recommendation 5.

OIG Position:

To reach management decision, RHS needs to provide us a copy of its revised handbook requiring the CSC's 1-percent QC review procedures to require use of tax return information obtained from the IRS when determining payment subsidy accuracy.

RECOMMENDATION 7:

If material reporting errors are identified during the 1-percent QC review when using IRS obtained information, revise *RD Handbook(s)* to expand the use of IRS verification to all borrower subsidy renewals.

Agency Response:

See Agency Response for Recommendation 5.

OIG Position:

To reach management decision, RHS needs to determine, based on historical data obtained from implementing Recommendation 6, if material reporting errors are identified during the 1-percent QC review when using IRS obtained information, and, if appropriate, revise *RD Handbook(s)* to expand the use of IRS verification to all borrower subsidy renewals.

Exhibit A – Summary of Monetary Results

FINDING NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	Unauthorized Payment Subsidies	$194, 777	Questioned Costs – No Recovery Recommended

USDA Rural Development

United States Department of Agriculture
Rural Development

JUL 06 2006

SUBJECT: Single Family Housing
Borrower Income Verification Procedures
(Audit Number 04099-341-AT)

TO: Robert W. Young
Assistant Inspector General
for Audit
Office of Inspector General

Attached for your review is Single Family Housing's response to the official draft for the subject audit dated June 30, 2006.

This response is being submitted for inclusion in the final report and your consideration to reach management decision on the recommendations.

If you have any questions, please contact Arlene Pitter of my staff at (202) 692-0083.

JOHN DUNSMUIR
Acting Director
Financial Management Division

Attachment

1400 Independence Ave, S.W. • Washington, DC 20250-0700
Web: http://www.rurdev.usda.gov

USDA Rural Development

United States Department of Agriculture
Rural Development

JUN 3 0 2006

TO: John Dunsmuir
Acting Director
Financial Management Division

FROM: David J. Villano 6/30/06
Deputy Administrator
Single Family Housing

SUBJECT: Office of the inspector General (OIG)
Audit Number 04099-341-AT
Official Draft – Single Family Housing
Borrower Income Verification Procedures

We have reviewed the OIG Official Draft report on the subject audit. Based on our review, we are pleased that there was no indication that any of the stated findings and recommendations presented a "material risk", and have not placed Rural Development at risk. This report also did not provide evidence of additional benefits/cost savings to either our customers or Rural Development.

Staff of our Centralized Servicing Center (CSC) provided clarification, in writing and personally discussed the audit report with members of the OIG staff on numerous occasions over the last two years. However, it is noted that several of the comments have not been considered, or incorporated, in the official draft.

Therefore, we respectfully request the following comments be considered and incorporated in the final report.

OIG Finding 1 – Cost Benefit Analyses Needed to Support Decisions Related to Cost Recovery Efforts for Unauthorized Payment Subsidies and Investigative Referrals

OIG Recommendation 1 – Conduct cost-benefit analyses to identify the dollar threshold to (a) investigate potential unauthorized assistance and (b) pursue delinquent unauthorized assistance. Revise the RD Handbook(s) accordingly.

Rural Development Response -

On page 3 of the report, the auditors stated:

> "...the agency has not performed a cost benefit analysis to support the $1,000 threshold. As a result, RHS did not attempt to collect unauthorized payment subsidies totaling $194,777 in FY 2004."

This statement is not accurate. CSC did perform a unit cost analysis in Fiscal Year (FY) 2001 using FY 2000 data. The data established that the $1,000 minimum unauthorized assistance (UNA) collection threshold is appropriate. The documentation that was provided to the Auditors during the audit fieldwork and the results had been previously incorporated into Rural Development handbooks. The funds OIG believes should have been collected (less than $200K) in FY 04 represented only 1.26% of the total UNA collected ($15.4 million) that year. Each UNA case that was not pursued was done so under published Rural Development instructions which did not require collection of claims under the $1,000 threshold.

RD followed and continues to follow the existing published guidelines. We agree that an updated unit cost analysis is warranted and pending the results of the updated analysis, will adjust the Handbooks accordingly. The original cost-benefit did not include litigious expenses. These will be included in the future analysis. We appreciate any recommendations that the OIG have to offer in updating the cost analysis.

OIG Recommendation 2 – Based on the results of the cost-benefit analysis to identify the dollar threshold for pursuing collection of delinquent UNA, compute the percentage increase of borrower income needed for referral to the UNA unit. Revise the RD Handbook(s) accordingly.

Rural Development Response –

Rural Development believes that the FY 01 justification and the previously submitted decision matrix are sufficient. However, upon completion of the cost benefit analysis noted above, we agree to compute the percentage increase of borrower income needed for referral to the UNA unit. We further agree to provide OIG the cost-benefit analysis and percentage increase in borrower income threshold documentation by October 2006. We again appreciate any recommendations that the OIG have to offer in updating the cost analysis.

OIG Recommendation 3 – Revise RD Handbook(s) to require borrowers to pay cost associated with pursuing/collecting delinquent unauthorized payment subsidies.

Rural Development Response –

Rural Development does not agree with this recommendation. The Audit report states that "...the cost of pursuing unauthorized payment subsidies that are in a delinquent payment status may be charged against the borrower's account." Unauthorized Assistance is not delinquent debt.

Title 31 U.S.C. Section 3717(e) does not require the cost of a UNA investigation to be passed on to the borrower. Rural Development does not support this recommendation based upon the following:

1. 7 CFR 3550.164 and HB-2-3550, Chapter 7, Section 1 clearly defines the Agency's collection strategy to ensure the collection or resolution of UNA debt prior to the debt becoming delinquent. Since this is not delinquent debt, the cost associated with unauthorized assistance should not be charged to the customer's account.
2. 7 CFR Part 3550.153 provides that fees, in the servicing of Direct Single Family Housing loans, may only be assessed for "...tax service fee, fees for late payments, fees for checks returned for insufficient funds." Rural Development cannot impose additional fees in its Handbooks as recommended by OIG.
3. Imposition of such a fee is contrary to the statutory intent of the program. This program is limited to very-low and low income families who cannot obtain credit elsewhere. As such, Rural Development does not charge fees to its customers except as authorized in published regulations (not Handbooks).
4. Customers who obtain UNA must repay this debt. As previously noted, these customers have very-low and low incomes and are unable to "graduate" to outside credit. Adding additional fees to UNA would increase the risk that the customer could not repay the adjusted debt and therefore increase our potential for loss.

We request "Management Decision" for this recommendation.

OIG Finding 2 – CSC's 1-Percent QC Review Uses a Flawed Sampling Methodology to Estimate the Overall Error Rate in its Universe of Payment Subsidies

OIG Recommendation 4 – Develop and implement a sound QC review sampling plan that randomly selects the 1-percent QC sample from the entire universe of payment subsidy renewals.

Rural Development Response –

On page 4 of the report, the Auditors conclude:

> "CSC's 1-Percent QC review uses a flawed sampling methodology to estimate the overall error rate in its universe of payment subsidies."

This conclusion was not supported by any test of conditions but only on the assertion of an OIG statistician. CSC has always maintained that the two-part sample methodology was unconventional, but did meet OIG's definition of random. Our conclusion is based on the fact that all accounts selected for initial review were selected randomly and had an equal chance of being selected for the 1-percent QC review.

However, on October 25, 2005, we implemented a new sampling method that is more direct and eliminates the confusion the prior two-part sample methodology generated. An automated Excel generator now produces our 1-percent sample.

Since the Excel generator provides an automated random sample, we conclude that the current process meets OIG requirements and therefore request "Management Decision" on this recommendation.

OIG Finding 3 – CSC QC Reviews Do Not Use Independent Federal Tax Information to Verify Borrower Incomes

OIG Recommendation 5 – Revise RD Handbooks to require all adult taxpayers in a borrower's household to submit a signed IRS Form 4506-T, "Request for Transcript of Tax Return," as a condition of eligibility for payment subsidy.

OIG Recommendation 6 – Revise RD Handbooks to require CSC's 1-percent QC review procedures to require use of tax return information obtained from the IRS to determine the accuracy of the borrowers' tax returns when determining payment subsidy accuracy.

OIG Recommendation 7 – If material reporting errors are identified during the 1-percent QC Review when using IRS obtained information, revise RD Handbooks to expand the use of IRS verification to borrower subsidy renewals.

Rural Development Response to 5, 6 and 7 –

On page 6 of the report, the auditors stated:

Exhibit B – *Agency Response*

> "We believe that requiring all borrowers to sign the IRS release Form 4506-T, "Request for Transcript of Tax Return" will improve the integrity of the program."

No evidence was presented by the OIG to support that any benefits realized would exceed the cost to implement this recommendation. No impact on the existing process with accompanying costs and additional burden to Rural Development, the borrower and the IRS was calculated. In addition, the definition of income for income tax purposes does not match the definition of income for payment assistance as prescribed by published Rural Development Regulations and Handbooks. Further, Rural Development "projects" income for the next 12 months to ensure that subsidy matches the needs of the customer. This requirement is based in large part upon previous OIG recommendation. Last year's income tax return is old data which does not accurately reflect the current income of our customers. This was discussed with the Auditors. Thus